

Fourth Quarter 2008

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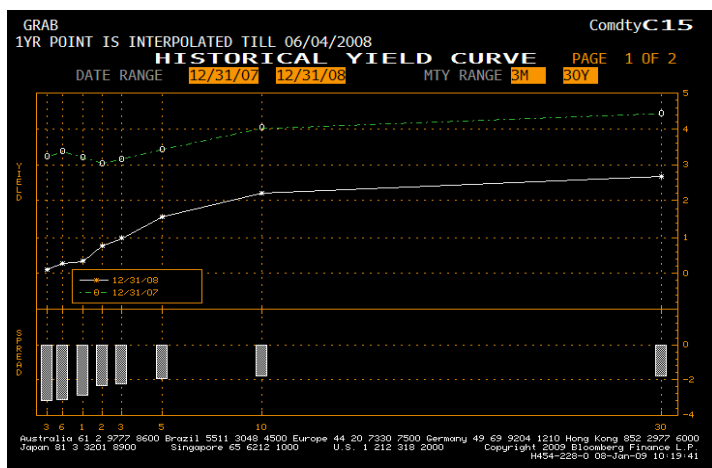
Review of 2008

For investors of all types, 2008 was a challenging year. At the end of the third quarter, the S&P 500 was down 19.3 percent. During the fourth quarter the S&P 500 fell an additional 21.9 percent, ending the year down 37 percent.

Despite the fear and anguish associated with the U.S. market declines, U.S. returns were among the best globally in 2008. The 2008 peak-to-trough decline of the S&P 500 was 52 percent, making it the third worst decline of the century. If you look at the worst decade during the century for the market (1928-1937) and what stocks did the following decade (1938-1948), you'll see stocks rose 100 percent during that period.

We believe the S&P 500 bottom of 741 reached on Nov. 21 will stand. The terrible performance of the stock market caused many investors to flee to risk-free U.S. government bonds. As you can see from Chart 1, this action caused the 3- and 6-month T-bill yields to fall close to zero and all interest rates to drop dramatically year-over-year.

Chart 1: Historical Yield Curve



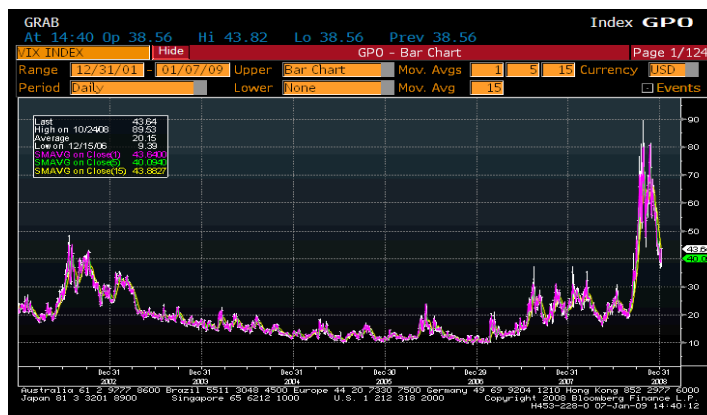
Economic outlook for 2009

As we look into 2009, we believe the equity markets will continue to be volatile, resulting in a bouncy ride. The economy will continue to deteriorate during the first half of

the year, and we'll see a gradual improvement in economic conditions beginning in the second half.

However, the Chicago Board Option Exchange's S&P 500 Volatility Index (VIX) indicates trading volatility will be more subdued in nature. We believe that the S&P 500 will rise at least 10 percent during 2009.

Chart 2: Volatility Index (VIX)



Portfolio strategy

The worst-performing sector of the year was financials, down 52 percent, followed by materials, down 39 percent for 2008. The best-performing sectors were consumer staples, down 12 percent, and healthcare, down 22 percent. For 2009 we expect the best sectors to include healthcare, consumer discretionary, energy and financials. During the fourth quarter our Investment Committee made the following changes to client portfolios:

- Overweight: Healthcare
- Underweight: Consumer discretionary, industrials
- Sells: Citigroup, Schlumberger and Cisco
- Purchases: Monsanto, General Mills, Bank of America, Amgen, Abbott Labs, Exxon-Mobil, Nike and Fluor Corporation

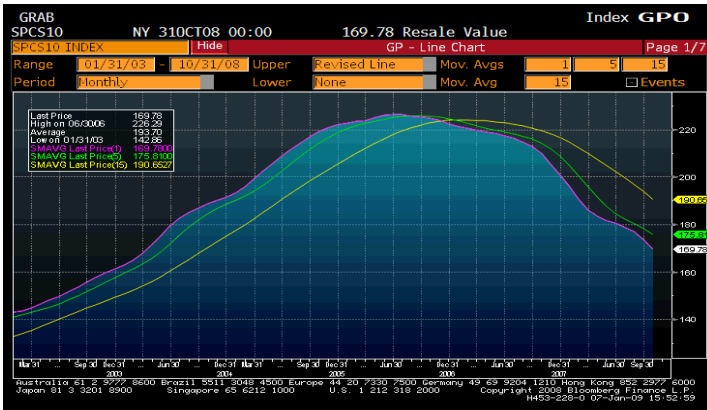
Home prices

Consumer spending comprises approximately two-thirds of U.S. gross domestic product. Consumer spending began to fall in later 2007 as residential real estate prices began to fall. Through October 2008 the S&P Case-Shiller Home Price Index indicates that home prices in the top 20 metropolitan markets have fallen 18 percent year-over-year. Our

Chart source: Bloomberg

committee believes that home prices will fall an additional 3-5 percent before stabilizing at a constant price level by the end of the year. As you can see below, a further decline in home prices could wipe out all of the price appreciation experienced since 2003.

Chart 3: Resale value



Our committee believes that a stabilization of home prices is necessary for consumer confidence and spending to bottom. We believe that the government's \$5 trillion dollar rescue of Fannie Mae and Freddie Mac, plus the government-led push to lower mortgage rates, will begin to show progress in the late third or fourth quarter of 2009.

Credit flow

Along with a declining housing market, the credit crisis that started in August 2007 reached its peak during September and October 2008. During this period the London Interbank Offered Rate (LIBOR) soared as banks hoarded capital and cut back aggressively on lending to lower their risk profile. These actions help spread fear that Wall Street's problems were causing capital to dry up on Main Street, further weakening consumer confidence and spending.

Chart 4 illustrates the restoration of the flow of credit to Main Street. The Federal Open Market Committee (FOMC), which cut fed funds an additional 2 percent to a range of 0.0-0.25 percent and led to an enormous increase in the monetary base, were the catalysts to restoring credit flow.

Chart 4: Restoring credit flow



Economic outlook

As we mentioned in our third-quarter newsletter, a stronger dollar and falling demand caused commodity prices to continue their downward spiral. During the fourth quarter of 2008 oil reached a low of \$38/bbl, down from its high of \$148/bbl last summer. We believe that improving economic conditions globally will increase demand for energy. Our 2009 forecast for oil prices is \$90/bbl.

Financial stocks, the worst-performing sector of 2009, will continue to experience credit losses associated with failing consumer credit card debt and mortgages. However, the FOMC and the Treasury are committed to preventing the failure of large banks to stop the meltdown effect that Lehman Brothers' failure created. They demonstrated this desire when they gave Citigroup an additional \$300 billion to wall off some toxic assets on their balance sheet. In the end, we believe financials are priced very attractively and will offer excellent returns in the years to come.

We believe that 4Q 2008 GDP will be down 3+ percent and that 1Q 2009 GDP will be down 1+ percent. Thereafter, GDP will begin to rise as the effect of lower interest rates, increased money supply and government stimulus takes hold. We expect the U.S. GDP to grow at a 2+ percent annual rate by 4Q 2009. Historically, stock prices rise six to nine months before a recession ends, hence our 10+ percent projection for the S&P 500. We believe 2009 will be a good year for stocks.